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A Clarification and Reformulation of Prevailing Approaches to Product Separability in Franchise Tie-In Sales

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Notes

A Clarification and Reformulation of Prevailing Approaches to Product Separability in Franchise Tie-In Sales

Contractual agreements that require franchise holders[1] to buy specified products from the franchisor, or from a source approved by the franchisor, may constitute illegal tie-in sales under section 1 of the Sherman Antitrust Act.[2] A tie-in sale occurs when a seller conditions the purchase of one product,[3] the

1. Franchise systems vary greatly, but most contain the following four elements: (1) the franchise is a legally independent member of the franchising system, although the franchise may be economically dependent on the franchisor; (2) the franchise business is operated with the advantage of the franchisor's name and standardization accruing to the franchisee; (3) the franchise system is developed for the express purpose of marketing the franchisor's products or services; and (4) a formal agreement exists that calls for a continuing, although not necessarily indeterminate, relationship between the franchisor and the franchisee. D. THOMPSON, FRANCHISE OPERATIONS AND ANTITRUST 7-8 (1971).

Through franchising, franchisees are able to obtain the advantages of national advertising and thus tradename recognition, as well as other economies of scale enjoyed by large, vertically integrated firms, while retaining their corporate independence. *See* Baker, *The Supreme Court and the Per Se Tying Rule: Cutting the Gordian Knot*, 66 VA. L. REV. 1235, 1253 (1980). See *infra* notes 42-45 and accompanying text for a more detailed analysis of the procompetitive effects of franchise agreements.

2. 15 U.S.C. § 1 (1976). "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." *Id.* The Sherman Antitrust Act was Congress's response to the perceived danger of "slavery that would result from aggregations of capital in the hands of a few individuals and corporations controlling . . . the entire business of the country, including the production and sale of the necessaries of life." Standard Oil Co. v. United States, 221 U.S. 1, 83 (1911) (Harlan, J., concurring in part and dissenting in part).

Tie-in agreements are also per se illegal under § 3 of the Clayton Act. 15 U.S.C. § 14 (1976). In the franchise context, however, because the tying product is the franchise trademark, *see, e.g.,* Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972), which is an intangible right appurtenant to an existing business or product, *see* United Drug Co. v. Rectanus Co., 248 U.S. 90, 97 (1918), the Clayton Act is inapplicable. The Clayton Act only applies to situations involving tangible commodities—"goods, wares, merchandise, machinery, supplies, or other commodities." 15 U.S.C. § 14 (1976). Consequently, private franchise tie-in actions are litigated exclusively under the Sherman Act.

3. Tie-in sales may involve products, services, or appurtenant rights, such

tying good, on the purchase of a second product, the tied good.[4] The seller is able to condition the sale because the high desirability of the tying good provides the seller sufficient market power to force the purchase of the less desired tied product.[5] Generally, courts have found tie-in sales to be anticompetitive and thus illegal per se[6] when substantial amounts of commerce are involved.

In the franchise tie-in context, the alleged tying product is the franchise trademark license.[7] Franchise tie-in sales are unique because of the special relationship between the product sold through the franchise system and the franchise trademark, and because of the purported procompetitive effects of franchises. Trademarks generally function to identify the source of a particular product or service, but in some cases may become indicia of the quality of the product, service, or method of production and thus represent and generate consumer good-

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as trademarks, copyrights, or patents. For brevity, this Note will use the word "product" to refer to any of the sales units that might be implicated in a tie-in.

4. *See, e.g.,* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958); Times-Picayune Pub. Co. v. United States, 345 U.S. 594, 605 (1953); F. SCHERER, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 505 (1970).

5. *See* F. SCHERER, *supra* note 4, at 505; *infra* note 21. See *infra* note 35 for limits on a seller's ability to force the purchase of the tied product.

6. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958); Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949); International Salt Co. v. United States, 332 U.S. 392, 396 (1947). Only agreements that constitute inherently unreasonable restraints of trade on their face are per se illegal. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958) (tying arrangement); United States v. Trenton Potteries Co., 273 U.S. 392, 397 (1927) (horizontal price fixing agreement). No actual anticompetitive effect of the challenged agreement need be demonstrated by a plaintiff under the per se standard. *See* United States v. Trenton Potteries Co., 273 U.S. at 397. The per se standard was first applied to tying agreements in *International Salt*. In that case, a lease agreement that required lessees of International machines to use only International's salt products was held illegal per se because "it is unreasonable . . . to foreclose competitors from any substantial market." 332 U.S. at 396. The Court broadened its condemnation of tie-in sales in *Northern Pacific* when it stated that tying agreements are "unreasonable in and of themselves." 356 U.S. at 6.

The Court appears to be decreasing its willingness to use the per se approach, however. In Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36 (1977), an exclusive territories restriction case, the Supreme Court overruled the per se rule that had been applied in similar circumstances in United States v. Schwinn, 388 U.S. 365 (1967). The *Sylvania* Court stated that per se illegality is "appropriate only when [the activities] relate to conduct that is manifestly anticompetitive." 433 U.S. at 49-50. Current economic analysis discounts the adverse economic effects of tie-ins, and thus casts doubt on whether tying agreements meet the "manifestly anticompetitive" criterion of *Sylvania*. *See* Baker, *supra* note 1, at 1267 ("Judged according to the market oriented standards of *Sylvania*, the rationale for the per se tying rule is inadequate."); *infra* note 35.

7. *See, e.g.,* Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

will.[8] In the franchise context, this close relationship between the trademark and the product with which it is associated complicates antitrust tie-in analysis,[9] which requires as a threshhold matter a determination that two separate products exist.[10] Franchise tie-in sales also present special problems because procompetitive policy considerations militate in favor of certain types of franchise tie-ins. Tie-ins facilitate the operation of franchise systems by providing the franchisor a needed mechanism to control product quality.[11] Thus, the anticompetitive effects of tie-ins must be weighed against the interests of franchisors who wish to protect the quality associated with their trademarks.

Franchise tie-in analysis has centered on whether the franchise trademark can be considered a product separate from the products sold under the trademark.[12] In *Siegel v. Chicken Delight, Inc.,*[13] the Court of Appeals for the Ninth Circuit concluded that a franchise trademark can constitute a separate product, and developed an approach to determine product separability based on a trademark's function. This approach distinguishes trademarks that identify product source from those that identify product quality.[14] Although subsequent decisions have generally followed the *Chicken Delight* approach,[15] two re-

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8. *See* Treece, *Trademark Licensing and Vertical Restraints in Franchising Arrangements,* 116 U. PA. L. REV. 435, 436-39 (1968).

9. *Cf.* Treece, *supra* note 8, at 435-36 ("The suggestion is sometimes made that the legal limits of franchisee control should be determined, not merely by antitrust policy, but by trademark policy as well. This suggestion implies the existence of a general principle which would restrain action otherwise dictated by antitrust considerations in deference to trademark policy.").

10. *See infra* note 12.

11. *See infra* notes 46-50 and accompanying text.

12. The product separability element is crucial in the tie-in context because "the very essence of a franchise is the purchase of several related products in a single competitively attractive package." Phillips v. Crown Cent. Petroleum Corp., 602 F.2d 616, 628 (4th Cir.), *cert. denied,* 444 U.S. 1074 (1979). If the franchise trademark only designates that the franchisor manufactured the product sold by the franchisee, then that franchise trademark cannot be found to be something separate from the tied product. *See infra* notes 81-94 and accompanying text; Note, *Trademark Franchising and Antitrust Law: The Two Product Rule for Tying Arrangements,* 27 SYRACUSE L. REV. 953, 954 (1976).

13. 448 F.2d 43 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972).

14. Product source trademarks signify that the franchisor manufactured the product sold by the franchisee; product quality trademarks represent that the product will be of a certain quality and that it was produced in accordance with the franchisor's standards. *See infra* notes 85-89 and accompanying text.

15. *See, e.g.,* Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977); Warriner Hermetics v. Copeland, 463 F.2d 1002 (5th Cir.), *cert. denied,* 409 U.S. 1086 (1972); Joe Westbrook, Inc. v. Chrysler Corp., 419 F. Supp. 824 (N.D. Ga. 1976); Detroit City Dairy, Inc. v. Kowalski Sausage Co., Inc., 393 F. Supp. 453 (E.D. Mich. 1975). *Cf.* Principe v. McDonald's Corp.,

cent Ninth Circuit cases, *Krehl v. Baskin-Robbins Ice Cream Co.*[16] and *Hamro v. Shell Oil Co.*,[17] restricted its application and contained language and analysis that make difficult any straightforward enunciation of the current version of the rule. These cases illustrate the difficulty of determining product separability under *Chicken Delight* and underscore the need for elaboration of the product separability test.

This Note attempts to clarify and reformulate prevailing approaches for determining product separability. Part I describes judicial rationales for the per se illegality of tie-ins and considers the unique and arguably procompetitive effect of tie-ins in the franchise context. Part II examines prior case law dealing with franchise tying arrangements, initially focusing on general tie-in illegality requirements and then recounting previous and alternative approaches to the Ninth Circuit's franchise product separability test. The Part then discusses, evaluates, and interprets the approach articulated in *Chicken Delight, Krehl,* and *Hamro*. Finally, the Note suggests a reformulation of this approach, presenting an analytic framework that reconciles the Ninth Circuit's cases and facilitates a more logical and unified treatment of product separability in the franchise tie-in context.

I. JUSTIFICATIONS AND CONSIDERATIONS FOR FRANCHISE TIE-IN ILLEGALITY

A. JUDICIAL RATIONALES FOR PER SE ILLEGALITY

The federal courts' per se standard of illegality for tie-in cases stems from their perception of tie-ins as monopolistic pricing devices lacking any legitimate business purpose.[18] The courts believe that tie-ins foreclose competition by extending monopoly power from one market to a second market (the so-called leverage theory),[19] and by creating barriers to entry for

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631 F.2d 303 (4th Cir. 1980) (finding nonseparate products), *cert. denied,* 451 U.S. 970 (1981); *see also infra* notes 75-80 and accompanying text.

16. 664 F.2d 1348 (9th Cir. 1982).

17. 674 F.2d 784 (9th Cir. 1982).

18. "Tying arrangements serve hardly any purpose beyond the suppression of competition. . . . The existence of market control for the tying device, therefore, affords a strong foundation for the presumption that it has been or probably will be used to limit competition in the tied product also." *Standard Oil,* 337 U.S. at 305-06. In Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958), the Court characterized tie-ins as having a "pernicious effect on competition."

19. *See* Standard Oil Co. v. United States, 337 U.S. at 306; Susser v. Carvel Corp., 332 F.2d 505, 511 (2d Cir. 1964). The leverage theory "works on the as-

potential competitors in the tied good market.[20]

The alleged extension of market power from the tying product market to the tied product market produces several perceived effects.[21] First, a tie-in forecloses the seller's competitors in the tied product market from buyers in that market.[22] Since the seller's market power in the tying product market allows it to require buyers who desire that product to buy the tied product from the same monopoly seller, other sellers are prevented from dealing with these buyers in the tied product market.[23] Courts condemn this foreclosure because "[c]ompetitors are denied free access to the tied market product, not because the party imposing the arrangement has a superior product, but rather because of the power of leverage exerted by the tying product."[24] This foreclosure thus runs

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sumption that the purpose of tying arrangements is monopolistic exploitation, achieved by 'artificially extending the market of the 'tied' product beyond the consumer acceptance it might rate if competing independently on its merit on equal terms.'" Comment, *Franchise Tie-Ins and Antitrust: A Critical Analysis,* 1973 WIS. L. REV. 847, 856. *See* D. THOMPSON, *supra* note 1, at 77.

20. *See* Bauer, *A Simplified Approach to Tying Arrangements: A Legal and Economic Analysis,* 33 VAND. L. REV. 283, 287 (1980).

21. Courts see the use of the tying product's market power in the tied market as enabling the creation of new market power in the tied product market. *See, e.g.,* Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 512 (1967); Betaseed, Inc. v. U & I, Inc., 681 F.2d 1203 (9th Cir. 1982); Moore v. Jas. H. Mathews & Co., 550 F.2d 1207, 1212 (9th Cir. 1977); Lockhart & Sacks, *The Relevance of Economic Factors in Determining Whether Exclusive Arrangements Violate Section 3 of the Clayton Act,* 65 HARV. L. REV. 913, 944 (1952). *See also* D. THOMPSON, *supra* note 1, at 77 (leverage theory generally).

All forced tie-in sales necessarily require some degree of market power by the seller over the tying product. Without this market power, the buyer would feel no compulsion to acquiesce to the tie-in terms. *See* Bowman, *Tying Arrangements and the Leverage Problem,* 67 YALE L.J. 19, 31 (1957) ("A tie-in is a useless device unless the supplier possesses substantial monopoly power over the tying product."); McCarthy, *Trademark Franchising and Antitrust: The Trouble with Tie-Ins,* 58 CALIF. L. REV. 1085, 1107 (1970) ("Sufficient economic power can be inferred from the fact that many franchisees accept [the tie-in]."). *See also* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6 (1958).

22. Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6 (1958); Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953).

23. Some commentators have argued that significant seller foreclosure from the tied product market requires a lack of alternative uses for the tied good and a great amount of market power in the tying good. These conditions are rare and should not exist in the franchise context. *See* Burstein, *A Theory of Full-Line Forcing,* 55 NW. U.L. REV. 62, 76 (1960). The portion of the tied product market foreclosed to other sellers would only constitute those tied goods purchased in conjunction with the tying good. The rest of the market would not be under the influence of the tying seller's market power in the tying product market. *Id.*

24. Betaseed, Inc., v. U & I, Inc., 681 F.2d 1203, 1215 (9th Cir. 1982). *See also* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6 (1958) ("They deny competitors free access to the market for the tied product, not because the party im-

contrary to basic principles of a competitive market philosophy. Because forces outside the parameters of supply and demand are involved,[25] competition is frustrated "on grounds unrelated to the inherent qualities of the tied product."[26]

Coercion of the buyer constitutes a second aspect of the leverage theory.[27] Tie-ins force buyers to purchase tied goods from sellers other than those from whom the buyer might purchase in a competitive market.[28] Courts consider the limitation on buyers' freedom to purchase from whomever they wish to be contrary to the competitive model.[29] Integral to federal antitrust policies is a desire to enhance individual economic freedom[30] by providing "freedom of action and the wide range of choices that freedom implies."[31] Because this desired indi-

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posing the tying requirement has a better product or a lower price but because of his power or leverage in another market.").

25. *See* J. HIRSCHLEIFER, PRICE THEORY AND APPLICATIONS 198 (1976) ("A competitive trader . . . regards himself as able to buy or sell any desired quantity at the current ruling price."). Price is set in a competitive market at the level at which the amount of the good supplied at a given price equals the amount of the good that will be bought at that price. Individual sellers cannot manipulate the market price but rather view it as fixed. *Id.* at 198-201. "[A]n industry is said to be competitive (or more precisely, purely competitive) only when the number of firms selling a homogeneous commodity is so large, and each individual firm's share of the market is so small, that no individual firm finds itself able to influence the commodity's price significantly by varying the quantity of output it sells." F. SCHERER, *supra* note 4, at 9. An important component of an "ideal" competitive market is the absence of barriers to entry of new firms. *Id.* at 10. Seller foreclosure, which constitutes a barrier to entry to the tied buyer's individual market, thus violates the competitive model.

26. Bauer, *supra* note 20, at 287.

27. *See* Fortner Enters. v. United States Steel Corp., 344 U.S. 495, 503, 512 (1967) (White, J., dissenting); Betaseed, Inc. v. U & I, Inc., 681 F.2d 1203, 1220 (9th Cir. 1982); Moore v. Jas. H. Mathews & Co., 550 F.2d 1207, 1212 (9th Cir. 1977).

28. *See* Standard Oil Co. v. United States, 337 U.S. 293, 306 (1949); Susser v. Carvel Corp., 332 F.2d 505, 511 (2d Cir. 1964); Comment, *Antitrust—Franchising—*Principe v. McDonald's Corp.*—Big Mac Attacks the* Chicken Delight *Rule,* 7 J. CORP. L. 137, 138 (1981); Comment, *supra* note 19, at 857. *Cf.* Continental T.V., Inc. v. GTE Sylvania, 433 U.S. 36, 53 (1977) (foreclosure of options to buyer is not sufficient for a Sherman Act violation in exclusive franchise context).

29. Through tie-ins, "a seller coerces the abdication of buyers' independent judgment as to the 'tied' product's merits . . . ." Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953). In a competitive market, buyers are free to choose from whom they wish to buy. Competitive markets are premised upon optimization of a buyer's individual preferences. If a buyer's choice is coerced, preferences are not optimized. *See* J. HIRSCHLEIFER, *supra* note 25, at 140 ("Economics concentrates upon . . . the integration of individuals' separate goal seeking activities through the market."); Slawson, *A Stronger, Simpler Tie-In Doctrine,* 25 ANTITRUST BULL. 671, 676 (1980).

30. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 5-6 (1958); Pitofsky, *The Political Context of Antitrust,* 127 U. PA. L. REV. 1051, 1056-57 (1979).

31. Blake & Jones, *The Goals of Antitrust: A Dialogue on Policy,* 65 COLUM. L. REV. 377, 383 (1965).

vidual freedom is curtailed when a tie-in restricts buyers' choices,[32] this "is in itself a lessening of competition."[33]

A third criticism of tie-ins under the leverage theory is that they create a monopoly in the tied product market.[34] Courts argue that the foreclosure of buyers to other sellers caused by the tie-in decreases the number of competitors, increases market concentration, and thus tends to create a monopoly.[35]

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32. *Id.* at 384.

33. Slawson, *supra* note 29, at 676.

34. *See* Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 513 (1967) (White, J., dissenting) ("The tying seller may be working toward a monopoly position in the tied product."); D. THOMPSON, *supra* note 1, at 77 (Court's concept of leverage encompasses idea of the establishment of a second monopoly). *Cf.* Posner, *Exclusionary Practices and the Antitrust Law,* 41 U. CHI. L. REV. 506, 508 (1974) ("People used to regard tying as a method by which a firm having a monopoly in one market . . . could obtain a monopoly of a second product . . . .").

Neither the Sherman Act nor the Clayton Act makes illegal the existence of monopoly power, but only agreements in restraint of trade or attempts to monopolize (Sherman Act) or acts which may substantially lessen competition (Clayton Act). The antitrust laws focus on the misuse of monopoly power, and thus tie-ins are condemned for the use of market power in a different market.

35. *See* Betaseed, Inc. v. U & I, Inc., 681 F.2d 1203, 1221 (9th Cir. 1982). *See also* Lockhart & Sacks, *supra* note 21, at 944 (alternative suppliers of tied product deprived of business of dealers depending on the tying product).

Economic analysts disagree with the courts' assumption that tie-ins are motivated by a seller's desire to extend monopoly power from the tying good market to the tied good market. Bauer, *supra* note 20, at 291. "The economists of the 'Chicago School' . . . have mounted a powerful attack on the implicit economic theory that underlies current policy of the law towards the allegedly exclusionary practices." Posner, *supra* note 34, at 506. Applying economic theory, economists assert that tie-ins cannot enhance a seller's monopoly power because the seller can extract monopoly profits in the tied market only to the same extent as his monopoly power in the tying market. *See, e.g.,* Burstein, *supra* note 23. *See generally* Markovits, *Tie-Ins, Reciprocity, and the Leverage Theory,* 76 YALE L.J. 1397, 1398 (1968). The buyer will regard the tying and tied products as a package. A seller uses its market power in the tying product market (its ability to sell above the competitive price) to compel purchase of the tied good. The seller initially has no market power in the tied market, however, so the buyer will only be willing to pay a price for the combined package of goods (the tying and tied products) equal to the monopoly price of the tying product and the competitive price of the tied product. If the price of the tied product is above the competitive level, the buyer will treat that difference as an increase in the price of the tying product and, thus, demand for the tying product will decline. *See* Moore v. Jas. H. Mathews & Co., 550 F.2d 1207, 1213 (9th Cir. 1977); Posner, *supra* note 34, at 508. The seller cannot increase monopoly profits by tying the two goods together, because monopoly rents in the tying product market present an upper limit to profits from the combined good package. Therefore, economists conclude that tie-in sales are not motivated by a desire to extend monopolies.

Economists argue that a more likely motivation for tie-in sales is that they facilitate price discrimination. Price discrimination is the activity of a seller with monopoly power attempting to increase its profits by extracting consumer surplus. Consumer surplus is the amount that a buyer would pay for a product in excess of the price charged, aggregated across all consumers. When buyer *A*

The second major rationale for holding tie-ins illegal per se is that would-be competitors are prevented from competing in the tied good market because the tie-in erects a separate barrier to entry.[36] Potential entrants to the tied product market must also produce the tying product to attract the buyers purchasing the tied products.[37] Entry into both markets requires extra capital and expertise,[38] and the tying product market poses barriers to entry that must be surmounted.[39] Courts characterize the consequences of this barrier to entry as "drastic."[40] Because the tie-in prevents competitors from entering the market, courts find tie-ins inherently anticompetitive.[41]

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is willing to pay $20 for a widget, and the monopoly price is $17 per widget, the buyer gains $3 in consumer surplus. A price discriminator will set different prices to sell to different buyers so price is closer to their actual valuation of the product. Thus, seller profits increase and consumer surplus decreases. *See* J. HIRSCHLEIFER, *supra* note 25, at 290-96; Posner, *supra* note 34, at 509. A monopolist can assume that a buyer who values a product highly will use that product more intensively than a buyer with a lower valuation. A tied good thus can serve as a monitor of intensity of use. *See* Burstein, *supra* note 23, at 64-65. The classic case is International Business Mach. Corp. v. United States, 298 U.S. 131 (1936).

Commentators have disputed the economic effects of such tie-in price discrimination, and thus it is unclear whether the use of tie-ins to price discriminate poses an argument for or against their illegality. *See* R. BORK, THE ANTITRUST PARADOX 381 (1978); Bauer, *supra* note 20, at 297; Bowman, *supra* note 21, at 93; Elzinga, *The Goals of Antitrust,* 125 U. PA. L. REV. 1191, 1205 (1977); Posner, *supra* note 34, at 510-13.

36. *See* Hirsch v. Martindale-Hubbell, Inc., 674 F.2d 1343, 1349 (9th Cir. 1982). A barrier to entry is any impediment a potential seller must overcome to enter the market. Barriers can range from technological (present seller has a technical advantage) to capital outlay requirements (large fixed, initial cost). Barriers to entry are essential for monopolists, because other businesses have an incentive to enter the monopolistic market if entry is free. *See* F. SCHERER, *supra* note 4, at 10 ("[S]ignificant entry barriers are the *sine qua non* of monopoly and oligopoly. . . . [S]ellers have little or no enduring power over price when entry barriers are non-existent.").

37. *See* Betaseed, Inc. v. U & I, Inc., 681 F.2d 1203, 1220 (9th Cir. 1982) ("Potential competitors may be required to enter simultaneously two separate product markets."); Bauer, *supra* note 20, at 288. These buyers desire both products. If they can obtain the tying product only from the seller requiring the tie-in, they are forced to acquiesce. They will buy the tied product from competitors only when they can also obtain the tying product from a source other than the tie-in seller.

38. *See* Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 494, 513 (1967).

39. The market power of the tie-in seller must be supported by some type of barrier. *See supra* note 36.

40. *See, e.g.,* Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 605 (1953); Betaseed, Inc. v. U & I, Inc., 681 F.2d 1203, 1220 (9th Cir. 1982).

41. The effect of the barrier to entry, however, will not be large in industries in which the tied product has substantial uses other than merely as a complement to the tying product, because the percentage of the tied product market unavailable to new entrants will be small. The amount of foreclosure in most franchise situations would be small, because products marketed under a

B. Procompetitive Effects of Franchise Tie-In Sales

In general, franchise systems promote competition by expanding the number of sales outlets and by creating efficiencies of production and distribution.[42] The intrinsic goodwill value of the franchise trademark allows franchisees to enter the market with little capital and a strong chance for success.[43] Without these advantages of franchising, fewer people would be able to operate businesses. Increasing the number of entrants into the market expands the distributive base, resulting in greater competition at the horizontal level[44] and retarding tendencies to-

specific franchise trademark are almost always marketed in other instances. For example, the market for hamburger buns, or ketchup, is not dependent on McDonald's—McDonald's occupies a very small percentage of the overall market. Therefore, foreclosure of sales to one franchise chain would not noticeably diminish the amount of business accessible to new entrants.

42. "Service establishments, traditionally burdened with high fixed costs, and too often lacking in managerial know-how, are responding to new techniques under the franchising system. Use of automated equipment, of tested standardized operating systems, and of carefully planned training methods—all help trim labor costs, enhance efficiency, and provide a more responsive customer service." 9 J. von Kalinowski, Antitrust Laws and Trade Regulation III-A-45 app. (1981) (deleted 1982). *See* F. Scherer, *supra* note 4, at 97.

43. It has been estimated that a franchise system has an eight times better probability of success than an independent small business. D. Thompson, *supra* note 1, at 33. "There are indications that members of franchise systems have substantially lower failure rates than do comparable independent businessmen. *Printers Ink* has claimed an overall *small* business failure rate of 60 percent, compared to only 10 percent for franchisees. Various studies show franchisee failure rates ranging from one percent to twenty-eight percent (of new franchises) per year." *Id.* "To the franchisee, franchising is probably the only business form which provides an individual with little capital or experience the opportunity to operate his own business with a reasonable chance of success." Comment, *supra* note 19, at 848. *See* Ungar v. Dunkin' Donuts of America, Inc., 531 F.2d 1211, 1222 (3d Cir. 1976); Note, *supra* note 12, at 958.

These figures suggest that a prospective retailer might prefer to enter the market as a franchisee rather than as owner of an independent business, thus causing a decrease in the total number of independent businesses in the market. This result could be viewed as anticompetitive, if viewed in isolation, but the tendency to discourage independent entry must be balanced against the huge increase in available entry caused by the franchise mode of business. On balance, many more individual entrepreneurs gain entry because of franchises than would without them.

44. The expansion of franchised businesses since 1950 has been called "phenomenal." D. Thompson, *supra* note 1, at 26. Because independent businessmen are able to obtain capital through the franchise system that they would not be able to obtain on their own, more businesses may enter the market to compete. *Id.* at 35. Increased entry decreases any one firm's percentage of the market, and thus its ability to control price by varying quantity. *See* F. Scherer, *supra* note 4, at 9.

"Perhaps the most important long-run contribution of the franchise form will be its role in broadening the distributive base of the economy through its encouragement of small business." D. Thompson, *supra* note 1, at 37. The beneficial economic effects of broadening the distributive base were explained in ward vertical integration.[45]

Because franchise systems are generally procompetitive, tie-in arrangements that facilitate these systems may be desirable. In situations in which the franchisor does not distribute a finished product, trademark license/product tie-ins allow the franchisor to control the quality of the product associated with the trademark by supplying its component parts, thus ensuring the trademark's goodwill value.[46] Quality control is essential to the franchisor's success, because the goodwill value of the trademark represents the reasonable expectation that the product will be purchased again.[47] If these expectations are not fulfilled, consumers will likely frequent a different sales outlet. Franchisors, therefore, are especially concerned with quality control.

Individual franchisees, on the other hand, have an incentive to lower quality, which decreases the franchisee's costs and increases the franchisee's profit margin.[48] The individual

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Susser v. Carvel Corp., 206 F. Supp. 636 (S.D.N.Y. 1962), *aff'd*, 332 F.2d 505 (2d Cir. 1964):

> The franchise method of operation has the advantage, from the standpoint of our American system of competitive economy, of enabling numerous groups of individuals with small capital to become entrepreneurs. . . . If our economy had not developed [franchising] these individuals would have turned out to have been merely employees. The franchise system creates a class of independent businessmen; it provides the public with an opportunity to get a uniform product at numerous points of sale from small independent contractors, rather than employees of a vast chain. The franchise system of operation is therefore good for the economy.

Id. at 640.

45. Vertical integration results when a franchisor decides to own and operate its retail outlets itself. *See* Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 379 (5th Cir. 1977); Burstein, *supra* note 23, at 84. "[F]ranchise arrangements may sometimes create better competitive markets than would otherwise exist . . . . [With vertical integration] competition at the local level would be as nonexistent under a system of national ownership of local stores as it would be under a franchise system utilizing explicit ties." *Kentucky Fried Chicken*, 549 F.2d at 379. *See* F. SCHERER, *supra* note 4, at 70 (discussing the anticompetitive effects of vertical integration).

46. Note, *supra* note 12, at 958. Tie-ins in some instances operate as quality controls which protect the value of the franchise trademark. The quality associated with the trademark determines its value. *Id.*

47. *See* Susser v. Carvel Corp., 332 F.2d 505, 519 (2d Cir. 1964); Treece, *supra* note 8, at 437; Note, *supra* note 12, at 957.

48. Baker, *supra* note 1, at 1278. Two different situations give individual franchisees an incentive to change quality. First, if they serve a large number of nonrepeat customers, individual franchisees do not expect these customers to buy from them again, and therefore, they are not as concerned with satisfying these customers. Second, if an individual franchisee services customers whose tastes vary from the general population, the individual franchisee will sell a product conforming to its customers' tastes and not the tastes of the general population (the customers of the franchisor). *Id.*

franchisee bears only a percentage of the cost of any consumer dissatisfaction,[49] while the franchisor bears the full cost. The interests of franchisors in maintaining the quality of the products associated with the trademarks, therefore, are significantly greater than those of individual franchisees. If franchisors are not allowed to use tie-ins to ensure product quality, and another, equally cost effective means of quality control is unavailable,[50] the franchise mode of operation will become substantially less attractive.

II. FEDERAL COURT DECISIONS CONCERNING PRODUCT SEPARABILITY IN FRANCHISE TIE-INS

Courts require the existence of three elements before they will hold a tying arrangement to be illegal per se. First, the sale must involve two separate products, with the sale of one, the tying product, conditioned on the buyer's purchase of the second, the tied product.[51] Second, sufficient market power (or monopoly power) must exist to compel the buyer to accept the tie-in.[52] Finally, the tie-in must affect a "not insubstantial" amount of interstate commerce.[53] Even when these three elements are present, however, a defendant may avoid application of the per se standard by raising the defense that a legitimate business purpose justifies the use of the tie-in arrangement.[54]

49. This is the "free rider" principle. Any customer dissatisfied with an individual franchise will associate his or her dissatisfaction with all of the franchises. The low quality individual franchisee, however, can still rely on the quality of all other franchises to maintain the public's perception of its quality. The effect of one individual franchisee's efforts to increase or decrease quality, therefore, is nominal and the individual franchisee will save more money by reducing quality than it will lose in consumer dissatisfaction. *See* Baker, *supra* note 1, at 1257-58.

50. Often quality can be controlled through specifications and other measures short of tie-in agreements, and in these cases the elimination of the tie-in would not inhibit the operation of the franchise system. Situations do exist, however, in which specifications either would be unworkable or would impose exorbitant enforcement costs on the franchisor. *See, e.g.,* Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348, 1354 (9th Cir. 1982); Susser v. Carvel Corp., 332 F.2d 505, 520 (2d Cir. 1964).

51. *See* Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 507 (1969); Times-Picayune Publishing Co. v. United States, 345 U.S. 594, 614 (1953).

52. *See* Northern Pac. Ry. Co. v. United States, 356 U.S. 1, 6 (1958). The requirement of sufficient market power to compel the tie-in is a heavily litigated issue in franchise tie-in cases. *See, e.g.,* Susser v. Carvel Corp., 332 F.2d 505, 519 (2d Cir. 1964) (franchise of ice cream stores lacked market power).

53. *Carvel,* 332 F.2d at 519.

54. *See* International Salt Co. v. United States, 332 U.S. 392, 397 (1947). This addition to the per se formula is termed the "modified per se test." *See* Comment, *supra* note 28, at 139.

The use of franchise tie-ins to ensure product quality and generate goodwill, to protect experimental products and industries, and to prevent wholesale consumer dissatisfaction constitute the three accepted business justifications for tie-ins.[55] This defense succeeds, however, only when the court determines that the method used by the seller was the alternative least restrictive to competition.[56] Courts generally have accepted business justification defenses only in limited circumstances.[57]

A major problem in tie-in litigation is that the courts have frequently confused and mixed together the quality control business justification defense with the initial requirement that there be separate products.[58] In *United States v. Jerrold Electronics Corp.*,[59] a nonfranchise case, the court concluded that a business justification defense[60] effectively reduced two prod-

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55. *See* Note, *Product Separability in Franchise Tying Arrangements: The Fourth Circuit's New Rule,* 38 WASH. & LEE L. REV. 1195, 1201 (1981).

56. Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368 (5th Cir. 1977). Kentucky Fried Chicken required its franchisees to buy carry-out chicken boxes, napkins, plastic utensils, and other supplies from it or from sources approved by it in writing. *Id.* at 373. The court stated that although product protection through tying can be legally legitimate, "the franchisor must establish that the tie constitutes the method of maintaining quality that imposes the least burden on commerce. If there are less burdensome alternatives, a franchisor is obligated to employ them rather than the tie." *Id.* at 376.

57. *See* Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949) (tying justification as mechanism to protect goodwill rejected because specification almost always an adequate safeguard); International Salt Co. v. United States, 332 U.S. 392, 397-98 (1947) (quality control defense rejected because salt judged capable of specification); Siegel v. Chicken Delight, Inc., 448 F.2d 43, 51-52 (9th Cir. 1971) (quality control justification rejected because tied products capable of specification), *cert. denied,* 405 U.S. 955 (1972); Susser v. Carvel Corp., 332 F.2d 505, 520 (2d Cir. 1964) (quality control justification accepted because specification of ice cream quality found impossible); United States v. Jerrold Electronics Corp., 187 F. Supp. 545, 560 (E.D. Pa. 1960) (tie-in of service allowed while product in "experimental stage" because of importance of service to success of the product).

58. *See generally* Ross, *The Single Product Issue in Antitrust Tying: A Functional Approach,* 23 EMORY L.J. 963 (1974); Note, *supra* note 55 (treating *Jerrold* as employing a two-step test for product separability).

59. 187 F. Supp. 545 (E.D. Pa. 1960).

60. Defendant Jerrold sold "state of the art" community television antenna equipment and tied its sale to mandatory service contracts. *Id.* at 552. Jerrold argued that the experimental nature of the business justified its exclusive right to service the product to ensure its proper functioning. The district court upheld the defense, reasoning that proper servicing of the antenna system was essential to the system's success, and that the performance of the initial antenna system would determine the ultimate success of Jerrold's business. *Id.* at 557. Tying experimental products to ensure favorable consumer results meets the business justification criteria when three requisites are met: 1) the success of the business must be dependent on the success of the first few systems; 2) the system must be technologically sophisticated; and 3) the justification exists

ucts into a single product, thereby removing the necessary first element of per se illegality from the analysis.[61] Thus, the court applied a business justification defense to the issue of product separability.[62]

Although the elements of per se illegality apply to all tie-in cases, franchise tie-in agreements present problems not found in standard tie-in litigation.[63] As a threshold matter, analysis of alleged franchise tie-ins must focus on whether the trademark and the alleged tied product actually constitute two distinct products and, if so, whether a business justification exists for the tying arrangement.[64] The product separability test in franchise tie-ins requires a determination that the franchise trademark has an identity distinct from the products sold under that trademark.[65] If the court finds two distinct products, the court will examine the tie-in arrangement for a business justification. Franchisors most commonly argue that the tie-ins are justified to protect product goodwill,[66] as other business

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only for the limited amount of time that the product remains in the experimental stage. *Id.* at 557-58.

61. *Id.* at 560 ("[T]he court concludes that Jerrold's policy of full system sales was a necessary adjunct to its policy of compulsory service and was reasonably regarded as a [single] product as long as the conditions which dictated the use of the service contract continued to exist.").

62. Nevertheless, *Jerrold* has been subsequently interpreted as applying a two-step test to the issue of product separability. The two-step test has been stated as follows. First, the court determines whether the tying and tied products are normally separate, and second, it decides whether a legitimate business reason exists for considering the two products as a single product. *See* Note, *supra* note 55, at 1199. This interpretation of the *Jerrold* language is supported by a footnote in *Jerrold,* which approvingly referred to "Jerrold's argument that it was selling a legitimate single product." *Jerrold,* 187 F. Supp. at 560 n.28.

63. It can be argued that the different factual context of franchises renders ordinary tie-in law completely inapplicable. One commentator has suggested that "[t]his difference may make the tying doctrine inapplicable in franchising because both the effects of and reasons for imposition of tie-ins may be different." Comment, *supra* note 19, at 858. *See also* Note, *supra* note 55, at 1201 (discussing *Jerrold*).

64. *See* Note, *supra* note 55, at 1201.

65. *See infra* notes 81-95 and accompanying text.

66. Courts normally will not accept this quality control defense if the use of specifications can ensure adequate quality control, since the defense requires the tie-in sale to be the least restrictive alternative. *See* Standard Oil Co. v. United States, 337 U.S. 293, 306 (1949); Kentucky Fried Chicken Corp. v. Diversified Packaging Corp., 549 F.2d 368, 376 (5th Cir. 1977); Carpa, Inc. v. Ward Foods, Inc., 536 F.2d 39, 46-47 (5th Cir. 1976); McCarthy, *supra* note 21, at 1111. The defendant must prove that specifications are too detailed and complex to be practical. *See* Susser v. Carvel Corp., 332 F.2d 505, 515 (2d Cir. 1964). These general rules might not apply so strictly to franchise tie-ins, however, because of the specific quality control problems inherent in the franchise system. *See supra* notes 46-50 and accompanying text.

justifications are rarely pertinent to the franchise context.[67] As in other tie-in contexts, however, the product separability and business justification doctrines have occasionally been mixed, causing confusion[68] as to whether the franchisor's ability to control quality through specifications relates to the product separability question.[69]

A. *CARVEL, PRINCIPE,* AND *CHICKEN DELIGHT*

The first major franchise tie-in case that expressly examined product separability was *Susser v. Carvel Corp.*,[70] in which the franchisor required its franchisees to buy ice cream mix and other products used in the preparation and sale of ice cream from the franchisor.[71] Focusing on Carvel's sales of component supplies as distinct items, the court found that the franchise trademark and the product ingredients constituted

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67. The experimental product defense is uncommon in franchise cases because most franchises are well developed by the time litigation arises (since the requisite of market power must be met for per se illegality), and thus the franchise business is no longer "experimental." Prevention of consumer dissatisfaction justifies tie-in sales when the proper functioning of the product requires its use in combination with a second (tied) product. Dehydrating Process Co. v. A.O. Smith Corp., 292 F.2d 653, 656-57 (1st Cir. 1961); Note, *supra* note 55, at 1201.

68. *See* Ross, *supra* note 58, at 989-93 ("The confusion engendered by this mixing of justifications has been the single greatest detriment to an understanding of the separability issue's proper place in the 'tying allegation.' "); Stewart, *Antitrust Considerations Involved in Product Distribution,* 19 BUS. LAW. 967, 995 (1964) (courts "inextricability [mix] discussion of reasonable business justification with talk of a single product being involved"). Two major problems result from this confusion. First, the burden of proof and the standards used to find "justification" are changed. Ross, *supra* note 58, at 992. The defendant has the burden to show that the tie-in is the alternative least restrictive to competition when business justification is used as an affirmative defense. A danger exists that these standards occasionally change when the business justification defense is included in the product separability analysis. *See* Principe v. McDonald's Corp., 631 F.2d 303 (4th Cir. 1980) (when court used analysis under product separability that belonged under business justification, the alternative least restrictive to competition was not used); Ross, *supra* note 58, at 992 n.146. The second, and major, result of the *Jerrold* confusion is the resulting inconsistency in case law analysis of franchise tie-ins. The possible harm of these inconsistencies is magnified by the general uncertainty concerning product separability in franchise tie-in litigation. *See infra* text accompanying notes 97-128.

69. *See infra* notes 110-11, 123-24 and accompanying text.

70. 332 F.2d 505 (2d Cir. 1964). This issue was also considered in FTC v. Carvel, 68 F.T.C. 128 (1965). The Commission, under the same facts as *Susser,* ruled that "Carvel's franchise agreements cannot be regarded as tie-in arrangements because the trademark's license conceptually cannot constitute a 'tying' product and, even if it could, it could never be regarded as a separate 'product' apart from the mix and commissary items to which it is attached within the meaning of the typical tie-in arrangements." *Id.* at 174.

71. 332 F.2d at 509.

separate products.[72] *Carvel*'s lasting significance lies not in the distinct products approach[73] used to determine product separability, but rather in that it was the first case to find a franchise trademark to be a separate product from the products sold under the trademark.

Two major approaches to franchise product separability have developed since *Carvel*. One approach is that enunciated in the Ninth Circuit's *Chicken Delight* line of cases,[74] and the other is that applied in the Fourth Circuit's recent *Principe v. McDonald's Corp.* decision.[75] The Fourth Circuit's radical departure from the Ninth Circuit's approach to product separability in the franchise context is illuminating. In *Principe*, McDonald's required its hamburger franchisees to lease their buildings from a McDonald's subsidiary.[76] The court took a deferential approach to the franchisor's concerns, and held that normally separate items could constitute a single product if they were essential ingredients of a franchise system's formula for success.[77] Restated, the issue was "whether the tied prod-

72. *Id.* at 514. *See* Siegel v. Chicken Delight, Inc., 448 F.2d 43, 47 (9th Cir. 1971) ("all three judges [in *Carvel*] regarded as a tying product the trade-mark license to ice cream outlet franchisees"), *cert. denied*, 405 U.S. 955 (1972). The tie-in agreement was held valid because the court split on whether these tie-ins were justified to control quality. The majority found that specification of quality standards for something as "insusceptible of precise verbilization" as ice cream quality was unreasonably burdensome. 332 F.2d at 520. This quality analysis is still quoted to support business justification defenses. The *Carvel* majority did not require Carvel's quality control measure to be the least restrictive alternative. In contrast, the dissent concluded that Carvel did not demonstrate that quality specifications would be inadequate to protect quality. It noted that Carvel did not manufacture the ingredients itself, so that if the franchisor could specify to its suppliers the required formulas, the same could be done for franchisees' suppliers. *Id.* at 515. The court was split on the business justification defense, but Judge Lumbard, who dissented on the business justification issue, wrote for the court on the other issues. *Id.* at 508.

73. 332 F.2d at 514. Distinct products is the test used in conventional tie-in arrangements. The inquiry is whether the tying and tied products are "physically distinct and capable of being sold separately."

74. *See* Hamro v. Shell Oil, 674 F.2d 784 (9th Cir. 1982); Krehl v. Baskin-Robbins Ice Cream Co., 664 F.2d 1348 (9th Cir. 1982); Siegel v. Chicken Delight, Inc., 448 F.2d 43 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972).

75. 631 F.2d 303 (4th Cir. 1980).

76. *Id.* at 304.

77. This test views normally separate items as one product if these items are an essential component of the franchise. *Id.* at 309 ("where the challenged aggregation is an essential ingredient of the franchised system's formula for success, there is but a single product and no tie in exists as a matter of law"). *See also* Zeidman, *Legal Problems in the Life Cycle of a Franchise*, 50 ANTITRUST L.J. 855, 861 (1982) (*Principe* held that product separability is not necessarily satisfied in a business format franchise); Note, *supra* note 55, at 1207. Critics of *Principe* argue that this broad and vague formulation demonstrates the current confusion in determining product separability. *See* Comment,

ucts are integral components of the business method being franchised."[78] Although the court described four unique aspects of the tied real estate leases that caused it to believe that the tied product constituted an integral component of the franchise's success,[79] it failed to enunciate a test for deciding when a product is or is not an "integral component." The court apparently included a business justification analysis in its determination of product separability by implicitly deciding that McDonald's had a legitimate concern that its franchises use a specific type of building.[80]

In contrast, the Ninth Circuit Court of Appeals in *Siegel v. Chicken Delight*[81] developed the "essential function" test to determine when a franchise trademark is separate from the products marketed under that trademark, overriding the distinct products approach to separability of *Carvel* that had previously prevailed. In *Chicken Delight,* the franchisor licensed its trademark to retail take-out chicken outlets. Instead of charging a

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Principe v. McDonald's Corp.; *The Separability Issue in Franchise Tying Arrangements,* 12 LOY. U. CHI. L.J. 839, 849 (1981).

78. 631 F.2d at 310. The court focused on the amount of planning and direction McDonald's gives its franchisees. The "franchisee pays . . . for the right to become a part of a system whose business methods virtually guarantee his success." *Id.* at 309. The court held that the building lease was thus not separable from the rest of the franchise because the building contributes significantly to McDonald's success. *Id.* at 311.

79. First, McDonald's was able to obtain better sites than could franchisees because of McDonald's superior "economic might" and its elaborate market research. Second, the tie-in assured that the store buildings would remain McDonald's stores. McDonald's Corporation's goodwill would be damaged if buildings identifiable as former McDonald's were subsequently used for other purposes. Third, by providing the building, McDonald's did not need to consider a potential franchisee's ability to obtain real estate when making selections, but could evaluate the applicants solely on their "management potential." Finally, the tie-in furthered the partnership relationship between McDonald's and its franchisees. *Id.* at 310. *See also* Comment, *supra* note 77, at 853-54.

80. *Principe* reflects a recent trend toward finding seemingly distinct products to be inseparable. The Ninth Circuit's decision in Hirsh v. Martindale-Hubbell, Inc., 674 F.2d 1343, 1350 (9th Cir. 1982), presents the most recent extension of this trend. Martindale-Hubbell required attorneys wishing to purchase advertisements to buy the directory itself, and required those purchasing professional cards to buy informative cards. *Id.* at 1346. The court held that no tie-ins existed because the products were inseparable. *Id.* at 1348. The court reasoned that the advertisements were only effective if the directory's circulation was large, that the directory sale requirement increased circulation, and, therefore, that where "the aggregate sale of ostensibly separate items serves to improve the quality of the product offered by the seller . . . no tying agreement is present." *Id.* at 1348. This analysis, that products are inseparable if the end product's quality is improved by the tie-in, is very similar to the integral components test of *Principe,* which examines the impact of the "tied product" on the overall success of the franchise.

81. 448 F.2d 43 (9th Cir. 1971), *cert. denied,* 405 U.S. 955 (1972).

franchise fee, the franchisor required its franchisees to purchase mixes, ingredients, and packaging and cooking equipment from Chicken Delight.[82] The Ninth Circuit held that these products were separable, comprising an illegal tie-in.[83]

The *Chicken Delight* court focused on the function of the trademark in analyzing the product separability question.[84] The court identified two functions of franchise trademarks: "source of product" and "representation of product quality."[85] A "source of product" trademark serves the traditional function of trademarks "as a strict emblem of source of the product."[86] A "representation of product quality" trademark, on the other hand, represents the manner in which the business is conducted. The franchisor certifies by way of the trademark that the end products are prepared, manufactured, or provided in accordance with the franchisor's standards, specifications, or methods,[87] reflecting the goodwill and quality standards of the franchisor.[88] Therefore, apart from maintaining a certain quality standard, the value of a tradename does not depend on the

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82. *Id.* at 46. The prices for these tied products were higher than comparable competitors' prices. *Id.* at 47. These inflated prices clearly indicated price discrimination by Chicken Delight in the sale of its franchises. *See* Baker, *supra* note 1, at 1260.

83. The court properly considered the product separability issue as distinct from the issue of whether the quality of the franchisee's product could be adequately controlled. 448 F.2d at 49.

84. *Id.* at 48-49. The defendant argued that the tied products were essential components of the franchise system. Therefore, they were not separate and distinct items. *Id.* at 47-48. The court recognized that "new questions are interjected" into tie-in cases by the franchise situation. In nonfranchise cases, courts consider "the function of the aggregation" of products in determining whether an aggregation of separate items is one product. *Id.* at 48. The analysis of trademark function was substituted for the analysis of aggregation function.

85. *Id.* at 48. *See generally* Note, *Quality Control and the Antitrust Laws in Trademark Licensing,* 72 YALE L.J. 1171, 1174-78 (1963) (tracing the historical derivation of the two essential functions of trademarks).

86. 448 F.2d at 48. A source product trademark bearing franchisor *X*'s label would verify that *X* manufactured the product. The court felt that this use "as a strict emblem of source of the product to which it attaches has largely been abandoned." *Id.*

87. The characterization of tradename franchising as an example of a representation of product quality trademark has been subsequently interpreted as the only type of franchise fitting this trademark function. The language of the court, however, is that "[t]his is particularly true in the case of a franchise system set up not to distribute the trade-marked goods . . . [but] to conduct a certain business under a common trade-mark or trade name." *Id.* These words arguably suggest that franchise arrangements other than tradename franchises fall under the product quality representation function, and perhaps even franchises that distribute trademarked goods serve the product quality function as well. *See infra* note 101.

88. 448 F.2d at 49.

source of the final product's component parts.[89]

The dichotomy between the final product sold and its component products is crucial to an understanding of *Chicken Delight*. The products tied by Chicken Delight—cooking utensils and equipment, mixes, and packaging—were used to create the final product sold under the Chicken Delight trademark; they were component products. The *Chicken Delight* court questioned whether the trademark's goodwill value depended on the component parts or their aggregate. For example, buyers are not concerned with the origin of the flour used in a hamburger bun. Rather, they merely expect the overall final product to conform to the level of quality they associate with the franchise. The *Chicken Delight* court stated that "[i]t is not what is used, but how it is used and what results that have given the system and its end product their entitlement to trademark protection."[90] The court also emphasized that the tied products were "common articles to which the public does not and has no reason to connect with the trade-mark."[91] Applying this functional analysis, the court concluded that the Chicken Delight trademark was a "representation of quality."[92] The court found that the mixes, ingredients, and equipment were component parts of the product to which the trademark's goodwill was insufficiently attached.[93] Therefore, the tying and tied products constituted separate items, and an illegal tie-in existed.[94]

This distinction between trademark functions constituted the major innovation of the Ninth Circuit in *Chicken Delight*.[95] The court distinguished franchise systems that distribute

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89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.*

93. The question whether a component part of the end product could ever be guaranteed by a trademark appears to be an open one. If a component part were advertised by the franchisor as being unique or integral to its products, the result in a "tradename" franchise case might be altered.

94. "The relevant question is not whether the items are essential to the franchise, but whether it is essential to the franchise that the items be purchased from Chicken Delight." *Id.* at 49.

95. In Principe v. McDonald's Corp., 631 F.2d 303 (4th Cir. 1980), which followed *Chicken Delight* by almost a decade, the Fourth Circuit examined the question, not specifically addressed in *Chicken Delight*, whether all "representation of product quality" trademark franchises necessarily require a finding of separate products. The court disregarded the *Chicken Delight* test of product separability, finding that court's emphasis on trademarks as the essence of the franchise to be too restrictive. *Id.* at 309. The *Principe* court disagreed that modern franchise trademarks only act as a guarantee of quality: "a modern franchisor such as McDonald's offers its franchisees a complete method of do-

trademarked goods (source trademarks) from those that conduct a certain business under a tradename (representation of product quality). *Chicken Delight* thus provided an analytic starting point, although it left unanswered many questions not raised by its facts.[96] Subsequent Ninth Circuit franchise tie-in cases, while generally adopting the *Chicken Delight* approach to product separability, have failed to apply the approach in a manner that would aid in resolving these questions.

In *Krehl v. Baskin-Robbins Ice Cream Co.,*[97] the Ninth Circuit applied the *Chicken Delight* trademark function analysis[98] to a franchise agreement and found a single product. The defendant, Baskin-Robbins, operated a nationwide chain of retail ice cream franchises. Under the franchise agreement, franchisees were required to purchase their ice cream from area franchisors.[99] The franchisees contended that this requirement constituted a per se illegal tie-in, because the sale of the Baskin-Robbins franchise (the tying product) was conditioned on the purchase of the Baskin-Robbins ice cream (the tied product). The Ninth Circuit held that no antitrust violation had occurred because the Baskin-Robbins trademark and the ice cream sold by the franchisees were "inextricably interrelated" in the public's mind[100] and consequently were not separate products.

The *Krehl* court reached its conclusion by relating the trademark functions identified in *Chicken Delight* to corresponding franchise systems.[101] The *Krehl* court recognized two

ing business. . . . Its regime pervades all facets of the business, from the design of the menu board to the amount of catsup on the hamburgers." *Id.* at 309.

96. For example, if several products are sold together in their finished form as a package, *Chicken Delight* provides no guidance as to whether these are component or final products. *See infra* notes 129-34 and accompanying text.

97. 664 F.2d 1348 (9th Cir. 1982).

98. The court did not consider the Fourth Circuit's approach to product separability developed in *Principe*. The *Krehl* plaintiffs argued that *Chicken Delight* held as a matter of law that a trademark always constitutes a separate product from the good sold under the trademark. *Id.* at 1352. The court correctly responded that *Chicken Delight* only held that in certain circumstances a trademark may be considered separate from the end product.

99. *Id.* at 1350. Defendants used a three-tiered organizational structure. The franchisor licensed both a small number of area franchisors and numerous retail franchisees. The area franchisors operated as middlemen, since they manufactured the ice cream (from a secret formula supplied by franchisor) and distributed it to the retail franchisees.

100. *Id.* at 1354. *See infra* notes 107-09 and accompanying text.

101. 664 F.2d at 1353. The *Krehl* court stated that these two types of franchise systems had been recognized and distinguished in *Chicken Delight. Chicken Delight,* however, focused only on the trademark functions and not the corresponding franchise systems. *See* 448 F.2d at 48-49.

general types of franchise arrangements, the "business format" system and the "distribution" system. A business format franchise, or tradename system, conducts its business according to the methods established by the franchisor, and the franchisee is generally responsible for the final production or preparation of the good.[102] Because consumers do not associate the franchise trademark with the component items, the trademark represents the general quality of only the end product.[103] In a distribution system, on the other hand, franchises serve as "conduits" for the distribution of a good.[104] The good is not produced at the franchise, but is produced by the franchisor and distributed by the franchisee. In such an operation, the franchise trademark is associated with the source of the finished, trademarked product.[105]

The *Krehl* court found that the Baskin-Robbins franchise system was a distribution system and not a business format operation. The ice cream was a finished product distributed through the franchise system and was identified by the Baskin-Robbins trademark, which represented product source. The court did not end its analysis, however, with its determination that the ice cream, the tied product, was not a component item. Instead, it proceeded to examine public perception of the franchise trademark[106] and the effect of quality control.

The test applied by the *Krehl* court to determine if the trademark identified product source was whether "[t]he desirability of the trademark and the quality of the product it represents are so inextricably interrelated in the mind of the consumer as to preclude any finding that the trademark is a separate item for tie-in purposes."[107] It concluded that no tie-in existed because the public always identifies the franchise

102. 664 F.2d at 1353.

103. A business format franchise corresponds to the representation of product quality trademark function. "Under such a system, there is generally only a remote connection between the trademark and the products the franchisees are compelled to purchase. This is true because consumers have no reason to associate with the trademark those component goods used either in the operation of the franchised store or in the manufacture of the end product." *Id.*

104. *Id.*

105. "[T]he trademark in a distribution franchise system often serves merely as a representation of the end product marketed by the system." *Id.* at 1354.

106. The court could have concluded its analysis at this point, and ruled that the products were inseparable, because the *Chicken Delight* approach implicitly leads to the conclusion that if a tied product is not a component product (in the broad sense of "component"), then the tied product is inseparable from the franchise trademark. *See supra* text accompanying note 89.

107. 664 F.2d at 1354.

trademark with the final product in a distribution system.[108] The tie-in doctrine had no application in this situation, "[b]ecause the prohibition of tying arrangements is designed to strike solely at the use of a dominant *desired* product to compel the purchase of a second *undesired* commodity."[109]

The *Krehl* court also distinguished *Chicken Delight* by stating that the quality of Chicken Delight products could have been maintained by "other means less intrusive upon competition."[110] This language is a clear recitation of the least restrictive alternative approach. The *Krehl* court appeared to say that the Baskin-Robbins trademark and ice cream were inseparable because there was no other method to control quality than to require purchases from area franchisors. It pointed to Baskin-Robbins's secret ice cream formula as conclusive evidence that product specifications were unworkable.[111] These statements suggest that the court considered the availability of quality control as an underlying factor in deciding the product separability issue.

Because the court did not focus on the absence of component items, but rather included the extraneous analyses of quality control and the public's perceptions, the *Krehl* approach does not neatly follow *Chicken Delight*. Nonetheless, the *Krehl* court's decision clearly accords with *Chicken Delight*. Two major factual distinctions explain the divergent results. First, final preparation of the food items occurred at Chicken Delight's franchises, while it did not at Baskin-Robbins's franchises.[112] The ice cream manufactured by Baskin-Robbins

108. *Id. Chicken Delight* had not explicitly required this conclusion. *Chicken Delight* developed the distinction between "product source" and "representation of quality" trademarks, but only dealt with the issue of whether a "representation of quality" trademark could be separate from the products sold under it. *See* 448 F.2d at 48-49.

109. 664 F.2d at 1354 (emphasis in original). The analysis behind this language is clearly misconceived. It is the franchisee who does not desire the tied product. In this case, the franchisee was forced to buy the ice cream (the undesired good) to obtain the desired good (the franchise). The court focused on the desirability of the tied good to the ultimate buyer, but the ultimate buyer is not the buyer of the tie-in. The court appeared to acknowledge this distinction, yet stated that "[t]he antitrust laws, however, are not designed to facilitate such a fraud upon the consumer." *Id.* at 1353 n.15. This policy concern is valid, but it does not correct the court's misguided analysis concerning desired and undesired goods. The *Krehl* court's focus on the ultimate buyer of a tied product differs radically from the current conception of what a tie-in is, and how it is analyzed.

110. *Id.* at 1353.

111. "Where, as here, the alleged tied product is manufactured pursuant to secret formulae, the specification alternative is not available." *Id.* at 1353 n.12.

112. The tied mixes and ingredients sold by Chicken Delight constituted a

was a final product, sold under the Baskin-Robbins trademark at the franchise, and was not a component of the final product. Second, the court in *Chicken Delight* defined a "product source" trademark as a "strict emblem of the source of the product."[113] The use of the Baskin-Robbins trademark fits this definition. The Baskin-Robbins trademark did not designate a method of making ice cream,[114] but rather a certain brand of ice cream. Because this trademark was a prototypical "product source" trademark, the result reached in *Krehl* followed the *Chicken Delight* approach and accords with a common sense perception of what people expect when they buy Baskin-Robbins ice cream.

In *Hamro v. Shell Oil*,[115] the Ninth Circuit relied on the *Krehl* analysis extensively when it examined whether a gasoline trademark and the gasoline sold under that trademark at a service station constituted separate products. The plaintiff Hamro operated a full service filling station which he obtained from Shell Oil Company under lease and dealer agreements.[116] Shell tied Hamro's use of its trademark to his exclusive purchase of Shell gasoline.[117] Although Hamro, unlike the Baskin-Robbins franchisees, sold products in addition to the tied gasoline,[118] the court found the gasoline inseparable from the franchise trademark and rejected Hamro's antitrust claim.

The *Hamro* court recited the two categories of trademarks from *Chicken Delight,* relied on *Krehl* to distinguish a source trademark from a representation of quality trademark, and then applied virtually verbatim the *Krehl* reasoning that a source trademark cannot constitute a separate product. It distinguished business format franchises from distribution

"multitude of separate articles" that produced one end product. 448 F.2d at 49. Component parts were deemed separate from the end product. The opposite occurred at Baskin-Robbins franchises, however. The ice cream was delivered in its final form to the franchise, where it was scooped out of the container and put on a cone.

113. 448 F.2d at 48.

114. A contrary argument might be raised, however. For example, major soft drink trademarks definitely stand for a particular product, and would appear to fit the source product function. These firms, however, manufacture only the syrup and allow independent bottlers to complete the soft drink. One might attempt to analogize the role of Baskin-Robbins ice cream in its cones or sundaes with that of the syrup in the creation of soft drinks. The problem is how to define trademark functions in these more ambiguous cases.

115. 674 F.2d 784 (9th Cir. 1982).

116. *Id.* at 786.

117. *Id.*

118. Hamro sold petroleum products, tires, batteries, automotive accessories, and mechanical service. *Id.*

franchises by stating that a business format franchisee "does not pass on a finished branded product, but actually prepares the product."[119] Because the court viewed the individual franchises to be "conduits" for the distribution of Shell gasoline,[120] Hamro's franchise did not meet the business format definition. The court then applied the *Krehl* criterion that one product exists if that product and the trademark are "inextricably interrelated" in the mind of the public, and determined that Shell gasoline and the Shell trademark were so interrelated as to constitute one product:[121] "the nexus between the trademark and the tied product, Shell gasoline, is sufficiently close to warrant treating them as one product."[122] This language constituted the court's sole explanation for classifying the Shell trademark as a source of product trademark. The decision did not analyze Shell's ability to control the quality of the gasoline through less restrictive means of quality control.

B. Problems with the Ninth Circuit's Current Approach

The results in *Chicken Delight, Krehl,* and *Hamro* appear to be consistent if one focuses on the distinction between final and component products. Unfortunately, these cases do not present an unambiguous analytic approach to franchise product separability, because the courts have considered several

119. *Id.* at 787.

120. *Id.* at 788.

121. Hamro also argued that the lease of his station from Shell was tied to the purchase of Shell gasoline. The court ruled that no tie existed because "Hamro would not have violated his lease if he had bought non-Shell gasoline and marketed it under his own name." *Id.* at 787.

122. *Id.* at 788. The court relied on Redd v. Shell Oil Co., 524 F.2d 1054 (10th Cir. 1975), as a second basis for its decision. The Tenth Circuit had found one product in "a factual context almost identical to the one" in *Hamro.* 674 F.2d at 788. Plaintiff Redd was a "jobber" who marketed gasoline as "Abajo Petroleum." A "jobber" resells petroleum products wholesale from major oil companies such as Shell to service stations. Shell required its "jobbers" to sell only Shell products under the Shell trademark. Redd argued that this requirement constituted an illegal tie-in, but the court rejected his claim.

The *Hamro* court's reliance on *Redd* is unfounded. The factual situation in *Redd* differs in several significant respects. First, *Redd* did business under the name "Abajo Petroleum," and thus did not fall under the goodwill of the Shell trademark in the service aspects of the franchise. Second, Redd did not operate a retail service station, but rather was a wholesale jobber. Unlike a service station operator, a jobber does not gain the benefits of Shell's marketing practices. Finally, the *Redd* court stated that because Redd had his business enterprise identified under his own name, "he did not have a franchise as the term has come to be used." 524 F.2d at 1056. Consequently, none of the special problems of franchise tie-ins applied to Redd. *See* Note, *supra* note 12, at 974 (distinguishing *Redd* from *Chicken Delight* because of the absence of an enterprise franchise agreement in *Redd*).

factors in addition to the final product and component product dichotomy and have used vague, imprecise language and standards. This line of cases reveals three major analytical problems with the Ninth Circuit's current approach: (1) it is unclear whether a court should consider a franchisor's ability to control product quality without the tie-in in determining product separability; (2) the guidelines to be used in deciding whether a franchise trademark represents the source of the product or product quality are ambiguous; and (3) insufficient attention is given to providing a framework for distinguishing component products from final products.

The *Krehl* court created a major analytic problem when it applied a business justification analysis to the product separability question by considering the efficacy of controlling product quality without the tie-in. In undertaking this analysis of quality control, the *Krehl* court deviated from the *Chicken Delight* emphasis on component and finished products; *Chicken Delight* did not even consider quality control to be an aspect of product separability. This mixture of standards in *Krehl* perpetuates the confusion originated in *Jerrold*[123] and fails to explain what is the decisive factor in determining product separability. The decision did not clarify whether the type of franchise or the ability to control product quality is determinative of product separability, nor did it make clear the extent to which franchise trademark function and the ability to control quality are interrelated, if at all. Would the Baskin-Robbins trademark still constitute a source of product trademark if it were possible for the franchisor to maintain adequate control over the quality of the ice cream by using specifications?[124] This is unclear following *Krehl*.

The *Hamro* court did not undertake a quality control analysis to determine whether quality specifications would be unworkable for gasoline. Application of quality control analysis to the product separability issue in *Hamro,* however, could poten-

123. 187 F. Supp. 545 (E.D. Pa. 1960); *see supra* notes 58-69 and accompanying text.

124. Esposito v. Mister Softee, Inc., 1980-1 Trade Cas. (CCH) ¶ 63,089 (E.D. N.Y. 1979), addressed this question in a context similar to *Krehl*. The defendant franchisor marketed "Mister Softee" ice cream through individual franchisees using a "Mister Softee" truck in which the ice cream is manufactured. The defendant required franchisees to purchase all ice cream ingredients and supplies from Mister Softee, Inc. The court found separate products, and focused on quality control as an affirmative defense. The court concluded that ice cream quality could be controlled by specification. The court distinguished *Esposito* from *Carvel,* and thus from *Krehl,* by noting the absence of a secret formula for "Mister Softee" ice cream. *Id.*

tially have changed the court's decision, because quality specifications are arguably viable in that context.[125] If the *Krehl* discussion of quality control indicates that this factor is significant in determining product separability, then arguably a gasoline trademark should be regarded as only warranting the quality of the gasoline rather than its source, because gasoline of the same octane level is fungible.[126] If gasoline is indeed fungible, the octane specifications should be sufficient to ensure and control gasoline quality.

The absence of any discussion of quality control in *Hamro,* which was decided after *Krehl,* suggests, however, that the Ninth Circuit does not consider the ability of the franchisor to control quality of the tied product without the tie-in to be a critical factor in product separability. The *Krehl* court's desire to distinguish *Chicken Delight* provides a possible explanation for the quality control language. Nevertheless, the discussion of quality control in *Krehl* is confusing and detracts from the development of a unified treatment of product separability in the franchise tie-in context.

Another troubling aspect of *Krehl* and *Hamro* is the court's extensive reliance on the public's perceptions of a trademark as a means of judging the trademark's function. The *Krehl* court stated that products are inseparable if they are "inextricably interrelated in the mind of the consumer."[127] This raises the problem of how a court is to ascertain whether the trademark and the product are "inextricably interrelated" in the

125. According to the Third Circuit, whether a particular gasoline dealership constitutes a *Chicken Delight* type of franchise is a question of fact. Bogosian v. Gulf Oil Corp., 561 F.2d 434, 452-53 (3d Cir. 1977), *cert. denied,* 434 U.S. 1086 (1978). In *Bogosian,* the plaintiff was a service station owner operating under the same type of tying arrangement as found in *Hamro*. Bogosian v. Gulf Oil Corp., 1980-2 Trade Cas. (CCH) ¶ 63,309, at 75,611 (E.D. Pa. 1980).

126. A product is fungible if it is interchangeable with another product. Gasoline would thus be fungible if no inherent difference in quality levels existed between brands. The issue of whether gasoline is fungible has twice survived summary judgment attacks in *Bogosian. See* 1980-2 Trade Cas. (CCH) at 75,612-13. In Redd v. Shell Oil Co., 1974-2 Trade Cas. (CCH) ¶ 75,390 (D. Utah 1974), *rev'd,* 524 F.2d 1054 (10th Cir. 1975), *cert. denied,* 425 U.S. 912 (1976), it appears that a major oil company did not dispute the fungibility argument. Shell explicitly stated in response to Interrogatory 5 that there is no difference in "Shell gasoline and other gasoline delivered to plaintiff or third persons." It should be noted that Shell purchased gasoline for resale under the Shell marks pursuant to exchange agreements and by specifications. 1974-2 Trade Cas. (CCH) at 98,267-68. The substantial exchange of gasoline among the major oil companies supports this fungibility argument, and the Utah District Court concluded that "petroleum products can be purchased by specification." *Id.* at 98,268.

127. 664 F.2d at 1354.

public's mind.[128] Should the court make a subjective evaluation, or should it examine objective evidence, such as consumer polls? The public perception standard was intuitively clear in *Baskin-Robbins,* given that people expect to buy ice cream manufactured by Baskin-Robbins at a Baskin-Robbins store. But multiple product situations like *Hamro* illustrate that intuitive clarity often fails in more complex situations. *Hamro* ruled that Shell gas and the Shell trademark are "inextricably interrelated," but it too failed to elaborate the standards it used to evaluate the public's perceptions. The public might perceive gasoline to be fungible, which would support characterizing the Shell trademark as a representation of product quality. Unfortunately, neither decision instructs future courts on how to determine the public's perception in this matter.

The third set of problems stemming from the *Krehl* and *Hamro* decisions is their emphasis on the overall franchise operation's relationship to the franchise trademark rather than the relationship between the tied product and the trademark, and their failure to develop a framework for distinguishing component products from final products. Both decisions at least partially rested on the distinction between franchises using component parts to produce an end product and franchises simply selling a finished product. It is unclear from the language used, however, whether this finished good dichotomy is intended to be determinative in all cases. *Chicken Delight* did not directly answer this question,[129] nor did it indicate how to analyze tied products sold in multiple product contexts. In a case in which the franchisee markets several finished goods, the franchise trademark might have some function in addition to identifying the source of the product.[130] If the franchisee markets both finished and unfinished goods, *Krehl* does not indicate what approach should be taken.

128. This type of public judgment should be distinguished from the "public's perception" of the level of quality it associates with a trademark. To conclude that a trademark and a product are "inextricably interrelated" in the public's mind, the court must merely determine that the particular product generates the goodwill represented by the trademark; it need not evaluate the extent of the goodwill.

129. *See supra* note 93. Similarly, the district court in *Krehl* left open the question whether every product source trademark and the underlying product are inseparable. "This Court does not conclude as a matter of law that a trademark used to designate product origin and the underlying product must always be a single product for purpose of tie-in claims." Krehl v. Baskin-Robbins Ice Cream Co., 1979-2 Trade Cas. (CCH) ¶ 62,806, at 78,706 (C.D. Cal. 1979).

130. For example, the trademark might represent the quality of the package of goods, the components of which are the several finished goods.

Krehl increased confusion over analyzing tie-ins in which multiple products are sold because of its deviation from the *Chicken Delight* "essential function" test. *Chicken Delight* focused on the function of the franchise trademark in relation to the tied product, while *Krehl* aligned franchise trademarks with either the business format or the product distribution franchise model.[131] The *Krehl* approach is problematic, however, because final products may be distributed and component products prepared at the same franchise. Consequently, the trademark function (representation of product quality or indication of product source) corresponding to the franchise model the court selects (business format or product distribution), may not accurately reflect the trademark's function with respect to the specific tied product. By focusing on the franchise model in which the tied product is sold, rather than on the tied product, the *Krehl* court moved even further away from the critical task of distinguishing final from component products.

The facts of *Hamro* present a situation in which deciding whether a particular item is a final or a component product becomes especially difficult. Unlike Baskin-Robbins, which sells only one product through its franchises, Shell markets multiple products. Shell dealers sell tires, oil, and automobile parts and service in addition to gasoline. The Shell trademark, therefore, may indicate both the source of certain products and the quality of the general car service the franchisee provides.[132] Arguably, gasoline might be associated with either of these trademark functions. For example, because Shell stations provide service for all aspects of the automobile and market the idea that their stations provide quality beyond the octane level of their gasoline,[133] one could view the sale of gasoline as but one component of that service, with the Shell trademark representing the quality of all products and services the station provides.[134] Still, the better result would be to view gasoline as a final product, as the Ninth Circuit did in *Hamro*. The gasoline

131. *See supra* notes 102-06 and accompanying text.

132. The mechanical service provided by Hamro is one clear example of a quality representation item sold by the franchisee.

133. Major oil companies spend a great deal of their marketing budgets in an effort to create an image of prompt, friendly, and reliable service at their stations. If gasoline is indeed fungible, and of a uniform quality, and the major oil companies all price at a somewhat uniform level, then they are forced to differentiate their lines of products in some other way. Selling service is one way to differentiate.

134. An additional problem in characterizing the trademark's function as identifying product source arises when the franchisor does not manufacture the product. For example, if Shell obtains gasoline refined by other oil compa-

is sold separately and the Shell franchise arrangement is designed primarily to distribute one product, namely, gasoline.

Hamro suggests, however, that cases will arise in which it will be extremely difficult to distinguish a final from a component product. Neither of the Ninth Circuit's other decisions, *Chicken Delight* or *Krehl,* is helpful in developing a framework to resolve the difficult cases, because each represents an extreme. In *Chicken Delight,* the tied products were ingredients used at the franchise to prepare the final product; they were unambiguously component parts. Just as clearly, the tied product in *Krehl,* ice cream, was sold as the final product at franchises.

The more difficult case arises when a product is delivered to the franchisee in its finished form, but is sold as an accompaniment to the dominant product of the franchise. An example of this situation would be a special sauce (condiment) sold at a roast beef sandwich franchise. The primary product sold is the sandwich. It is prepared at the franchise in a "business format" operation similar to that in *Chicken Delight,* and the franchise trademark consequently would be characterized as a "representation of quality." The sauce is different from the component products tied in *Chicken Delight,* however, because the franchisee could not sell those products (mixes, paper products) independently; they were necessarily component products. The sauce, on the other hand, bears the name of the franchisor and can be bought separately for home use. Although the franchisee obtains the sauce as a finished product, the sauce's predominant function is to enhance the roast beef sandwich—it is available without cost to customers at the restaurant site just as ketchup is provided with french fries. The use and function of this finished product, therefore, is very different from that of ice cream at a Baskin-Robbins franchise.

This scenario illustrates the problem of using current Ninth Circuit approaches to product separability when the tied product appears to be a finished product and is sold in a business format franchise. Whether there is a product separability question turns on how one characterizes what the franchise sells and on which product the court focuses. Because the Ninth Circuit cases have not yet considered the multiple product context, they do not suggest a coherent framework for resolving product separability in a more difficult case. The alternative

nies, then it is more difficult to see how the trademark's function can be to identify product source, because Shell has not produced the product.

approach of the Fourth Circuit in *Principe v. McDonald's Corp.*[135] provides no solution to the problem either. The integral component analysis employed in *Principe* can be manipulated to include almost any product used in a franchise business. Such a broad test does not adequately protect the courts' underlying concern for the promotion of free economic choice in the marketplace. Rather, a reformulation of the Ninth Circuit's basic approach that eliminates some of the vague and immaterial language found in the case law, and deals specifically with distinguishing component from final products, will facilitate a more reasoned application of the Ninth Circuit's franchise product separability test.

III. A REFORMULATION OF THE NINTH CIRCUIT'S APPROACH TO PRODUCT SEPARABILITY

The underlying criterion used by the Ninth Circuit for determining whether two separate products exist in franchise tie-in litigation is the dichotomy between component and final products. When the tied products considered by the court were sold as final products, the court held that the trademarks and the products were inseparable. On the other hand, when the tied product was only a component of the product sold by the franchisee, as in *Chicken Delight,* the court found the trademark did not signify product source, and thus was separable. Discussions in *Krehl* of a franchisor's ability to control quality and of the public's perception of a trademark's function as aspects of product separability, however, detract from a clear understanding of the Ninth Circuit's approach to franchise product separability. The following reformulation eliminates these confusing aspects and presents a clearer framework with which to distinguish final from component products in the few instances in which this distinction is not readily apparent.

The product separability test in the franchise context can be reformulated simply by characterizing the tied product as either a final product distributed through the franchise system or a component of the dominant end product sold by the franchisee. This test makes explicit the implicit primary criterion employed by the Ninth Circuit. This test does not consider the public's perception of the trademark function or any quality control analysis in determining product separability. Quality control analysis is confined to its traditional role as an affirmative business justification defense.

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135. *See supra* notes 75-80 and accompanying text.

If the tied product is delivered to the franchise in its finished form, and is not sold in conjunction with other products, the tied product will be found to be a final product and thus inseparable from the trademark. Conversely, if the tied product is combined with other items to produce the end product sold under the franchise trademark, and in so doing the tied product is altered, it will be held to be a component product separable from the franchise trademark. This simple analysis will resolve the vast majority of cases.

More difficulty arises in making the distinction between component and final products when the tied good is a finished product but sold in a multiple product context.[136] In this situation, the court must determine if the tied, finished product actually constitutes a component of a package of goods that are sold by the franchise as one multifaceted, integrated product or service.[137] To make this determination, the court should consider six factors: (1) whether the multiple products are normally sold together;[138] (2) whether they are used interdependently and for the same or similar purposes;[139] (3) whether the products are used as materials for service or repair provided by the franchisee;[140] (4) whether the franchisor establishes detailed standards and regulations for the manner in which the package products sold are utilized;[141] (5) whether

136. A multiple product context should be defined as a franchise that sells finished products, or a mixture of finished and component products, as a package.

137. Automobile servicing arguably is an example of a multifaceted, integrated product. A clearer example is a tradename wax applied in a car wash franchise. The central criterion with which to make the integrated product determination is whether the final product sold is significantly different from, enhanced by, or improved over the tied product (i.e., whether the character of the tied product has been sufficiently changed to justify calling it a component of some other product).

138. Selling products together as a package indicates that they are designed for a common purpose and that the products are components of one integrated product.

139. If products are used together to achieve the same purpose or result, then they can be characterized as components of one product aimed at a particular result. This use of products is very similar to the use of component products in *Chicken Delight*.

140. The use of the tied product in service or repair work performed by the franchisee supports the inference that the tied product is not the end product bought by the consumer. A customer is paying to have his car fixed, not necessarily to have a particular brand of valve put in.

141. Standards or directions constitute the additional ingredient that might transform what ordinarily would be just a bundle of goods into one integrated product. If special, expert uses are made of the tied product, then the whole package would exceed the sum of its parts. Something more than the finished good is being sold by the franchisee.

"The business format franchise involves the exploitation not merely of the tied product is manufactured by someone other than the franchisor;[142] and (6) whether the tied product is sold together with a more dominant product that is produced at the franchise. Consideration of these factors would aid in deciding the extent to which the tied product acts as a complement to the other products or whether it functions independently. The greater the number of factors present, with emphasis on factors two and six, the more evidence there is that the tied product is a component of the end product marketed by the franchisor.

This reformulation provides a useful predictive tool. Parties will be better able to assess the merits of their claims, and more intelligent negotiating and decreased wasteful litigation will result. The test's easy application and predictive value is apparent when one applies it to determine product separability in *Chicken Delight, Krehl,* and *Hamro*. The *Chicken Delight* tied products, for example, are clearly component products. They are used at the franchise to produce and package the final product—chicken. Consequently, they constitute products separate from the trademark. The Baskin-Robbins ice cream in *Krehl,* on the other hand, is a final product, because it is a finished product in a nonmultiple product context when delivered to the franchise. This determination would end the court's analysis. The tied product would be held inseparable from the trademark without the needless and confusing consideration of whether the tied product and the trademark are "inextricably interrelated" in the public's mind. Finally, because multiple products were sold at the service station franchise in *Hamro,* a court would consider the six factors described earlier to determine whether gasoline constitutes a final or component product of the franchise. Because gasoline is sold by itself and is the dominant product sold by the franchisee, a court would classify it as a final product, and the gasoline and the trademark would not constitute separate products.

The test is especially useful in approaching the hypothetical case of sauce sold at a roast beef sandwich franchise. This

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goods identified by a trade mark or an invention, but the preparation of the blueprint of a successful way of carrying on a business in all its aspects. The blueprint must have been so carefully prepared as to minimize the risks inherent in opening any new business." M. MENDELSOHN, THE GUIDE TO FRANCHISING 4 (3d ed. 1982).

142. A franchisee's claim that its trademark represents product source is much weaker, by definition, if the franchisor did not actually manufacture the tied product. For example, Chicken Delight did not manufacture the tied items, while Baskin-Robbins, through its area franchisors, did. In *Hamro,* it is unclear whether Shell actually refined the gasoline.

case is an example of a product delivered in a finished form to the franchisee that likely would be found to constitute a component product after a consideration of the factors listed in the reformulation. Although it may be sold separately, the sauce's primary use in the franchise scheme is as a complement to the primary product of the franchise—the roast beef sandwich. Factor one is satisfied because the sauce is sold, or in this case provided, primarily with the sandwich. Since the sauce and sandwich are used interdependently, factor two also exists, and factor six is present because the roast beef sandwich is clearly the more dominant of the two products. Factor four might also exist, because it is quite probable that a franchisor would establish standards for the use of the sauce.[143] The existence of these factors indicates that the sauce is primarily used in conjunction with the sandwich, to enhance and improve it. Thus, its primary function is as a component of the primary product of the franchise, which makes it separate from the trademark.

Contrasting the Fourth Circuit's approach in *Principe v. McDonald's Corp.*[144] with this reformulation demonstrates the need for one further refinement in any consideration of franchise tie-in sales. The revised Ninth Circuit approach is vastly superior to that of the Fourth Circuit because it does not contain the elastic quality of the *Principe* "integral components" test. Yet the legitimate desire of the *Principe* court to promote franchising of business is not fully met by an approach to franchise tie-ins that allows a franchisor to use the tie-in to ensure control of the tied product's quality only if the tie-in is the alternative least restrictive to competition. A quality control defense currently will fail if any alternative, though costly to the franchisor, is adequate to ensure product quality.[145] The Ninth Circuit should relax this business justification requirement for franchise tie-ins, which would not be inconsistent with the philosophy of quality control expressed in *Krehl*. If some mechanism, such as specification of quality standards, can ensure product quality without a cost to the franchisor that is unreasonable in the judgment of the court, then the tie-in of a component product should be illegal. A court should not require, however, that the tie-in be the alternative least restrictive to competition, but should rather apply its own judgment as to reasonable costs, keeping in mind the policy goals of pre-

143. *See* Principe v. McDonald's Corp., 631 F.2d 303, 309 (4th Cir. 1980) (McDonald's specifies the amount of ketchup on the hamburgers).

144. *Id.*

145. *See supra* notes 56-57 and accompanying text.

serving freedom of economic choice without discouraging the franchise mode of business.[146] The legitimate needs of franchisors will be better met, and courts will not be forced to manipulate product separability findings to protect the franchisor's needs.[147]

IV. CONCLUSION

Prevailing approaches to product separability in franchise tie-in sales have become unpredictable and confusing. An initial solution lies in reformulating the approach suggested by the Ninth Circuit in *Siegel v. Chicken Delight, Inc.* The reformulation proposed in this Note concentrates solely on determining whether the alleged tied product is a component or a final product. It develops an analytic framework that produces results consistent with recent Ninth Circuit cases while facilitating the resolution of more difficult cases.

146. The court should specifically consider the cost to the franchisor of enforcing and policing the specifications. The past use of specifications in the industry, the cost and policy problems of these specifications, and whether efficiencies exist for production of the tied product by the franchisor should also be evaluated.

147. "The 'two products' characterization may be the only way for the lower courts to avoid per se condemnation of practices that they regard as innocuous or even beneficial." Baker, *supra* note 1, at 1313.